



STATE OF UTAH INSURANCE DEPARTMENT

REPORT OF FINANCIAL EXAMINATION

of

EDUCATORS MUTUAL INSURANCE ASSOCIATION

of

Salt Lake City, Utah

as of

December 31, 2005

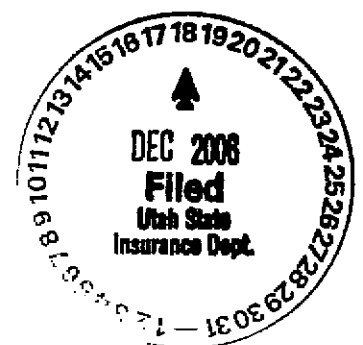


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September 22, 2006

Honorable D. Kent Michie
Insurance Commissioner
State of Utah
3110 State Office Building
Salt Lake City, UT 84114

Commissioner:

Pursuant to your instructions and in compliance with statutory requirements, an examination, as of December 31, 2005, has been made of the financial condition and business affairs of:

EDUCATORS MUTUAL INSURANCE ASSOCIATION
Salt Lake City, Utah

hereinafter referred to in this report as the "Association" or "EMIA", and the following report of examination is respectfully submitted.

SCOPE OF EXAMINATION

Period Covered by Examination

The current examination covers the period from January 1, 2002, through December 31, 2005, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination.

A letter of representation attesting to the Association's ownership of all assets and to the nonexistence of unrecorded liabilities was signed by and received from the Association's management at the conclusion of the examination.

Examination Procedure Employed

The examination included a general review and analysis of the Association's operations, the manner in which its business was conducted, and a determination of its financial condition as of December 31, 2005. The examination was conducted in accordance with generally accepted standards and procedures of regulatory authorities relating to such examinations.

Status of Prior Examination Findings

The previous examination was performed by the Utah Insurance Department (the Department) as of December 31, 2001. Items of significance noted in the prior examination report are the following.

- Several members of the board of directors identified interests that may give actual or potential conflict with their duties or judgment as an employee of the Association. (See Conflict of Interest Procedure)
- The Association did not notify the Commissioner in writing of its intention to enter into the 2001 Educators Administrative Services, Inc. (EASI) management agreement, nor was the Commissioner notified of amendments to other agreements at least 30 days prior to entering into the agreement and amendments as required by U.C.A. § 31A-16-106. A Form D, Prior Notice of a Transaction, with regard to the amendment to the management agreement with EHC was filed in September of 2002. (See Transactions with Affiliates)
- Several accounts and records deficiencies were identified. (See ACCOUNTS AND RECORDS)
- Material adjustments and reclassifications were made to the reported balance sheet amounts. (See ACCOUNTS AND RECORDS)
- The Association obtained legal representation in response to a U.S. Department of Health and Human Services, Office of Inspector General document subpoena, dated November 8, 2002, concerning the Association's compliance with certain provisions of the Medicare Secondary Payer Statute and implementing regulations. In addition, the U.S. Department of Justice and the U.S. Attorney's Office for the District of Utah have informed the Association that it is a named defendant in a related qui tam action in a United States District Court for the District of Utah. (See Territory and Plan of Operation)

HISTORY

General

The Association was organized on June 16, 1935, as a non-profit mutual benefit association. The Utah Education Association, an organization of Utah educators, sponsored and participated in the creation of the Association in order to provide insurance protection to educators. The Association's original name was Utah Teachers Welfare Association. The name was changed to its present name on October 7, 1965. In 1994, the Association filed a business name registration application with the State of Utah Division of Corporations and Commercial Code to record a "doing business as" (d/b/a) Educators Mutual Insurance Association.

The Association operates under Utah Code Annotated (U.C.A.) § 31A-5-108. The Association is authorized to transact life, annuity, and accident and health lines of insurance.

The Association's bylaws were amended on November 9, 2002, making the number of members of the board of directors to be fifteen. Eleven directors are to be elected by the membership and four directors to be appointed by the elected directors. Four of the members of the board must have insurance, financial, legal, medical or general business experience. The four board members must be approved the Utah Insurance Commissioner.

On December 15, 2005, the Association amended its bylaws to specify new standards for individuals to be eligible to become members in the Association.

Membership

The Association's articles of incorporation require that members be individuals employed by Utah public school districts, institutions of higher education, other agencies or political subdivisions primarily engaged in public educational activities, or employees of organizations comprised of public education employees.

Management

The Association's bylaws set the number of directors at fifteen. The members of the Association elected eleven directors, and the elected directors appointed four directors. Any vacancy may be filled by a majority vote of the directors. The following persons served as directors of the Association as of December 31, 2005:

<u>Name and Residence</u>	<u>Principal Occupation</u>
Arlene Arnold Orem, Utah	Uniserv Director Eastern Utah Uniserv
Michael Evans Fillmore, Utah	Teacher Development Trainer Millard School District
James C. Fontaine Salt Lake City, Utah	Retired Senior Vice President/CFO Deseret Mutual Benefit Administrators
Michael R. Francis Orem, Utah	Controller and Assistant Vice President for Business Services, Utah Valley State College
Paul R. Gottfredson Ephraim, Utah	Business Administration South Sanpete School District
Lynette Grow Riverdale, Utah	Teacher Weber School District

Wallace G. Harmer
Salt Lake City, Utah

Retired Business Administrator
Salt Lake School District

Michael W. Hepner
West Jordan, Utah

Executive Director
Utah School Employees Association

Henry E. Jolley
Lindon, Utah

Retired Superintendent of Schools
Beaver County School

Susan Kuziak
Salt Lake City, Utah

Executive Director
Utah Education Association

Timothy Leaman
Paradise, Utah

Teacher
Cache County School District

Roger A. Pate
Orem, Utah

Physical Facilities Supervisor
Alpine School District

Randy R. Smart
Sandy, Utah

Attorney
Smart, Schofield, Shorter & Lunceford

James M. Thompson
Price, Utah

Teacher
Carbon School District

Scott C. Thornton
Centerville, Utah

Chief Actuary
Deseret Mutual Benefit Administrators

There were several committees of the board of directors as of December 31, 2005. The primary committees were the following:

Executive Committee

Audit Committee

Wallace G. Harmer, Chair

Michael R. Francis,
Chair

Michael R. Francis
Susan M. Kuziak
James C. Fontaine
Michael W. Hepner
Rolando I. Galano

Arlene Arnold
Wallace G. Harmer
Roger A. Pate
James M. Thompson

Finance Committee

James C. Fontaine, Chair
Michael Evans
Henry E. Jolley
Timothy Leaman
Scott C. Thornton

Legislative Committee

Mike Hepner, Chair
Paul R. Gottfredson
Lynette Grow
Susan Kuziak
Randy R. Smart

Officers of the Association as of December 31, 2005, were as follows:

<u>Name</u>	<u>Title</u>
Rolando I. Galano	President/Chief Executive Officer
David S. Glauser	Vice President, CFO - Treasurer
Reagan S. Wood	Chief Operating Officer, (COO) Secretary
Ryan D. Hortin	Vice President
John J. Javorsky	Vice President
Christie H. Hawkes	Vice President
Steven C. Morrison	Vice President
Laverne Zaloba	Vice President
Joseph H. Campbell	Vice President
Tiffany Bermingham	Vice President
Jennifer Gallegos	Vice President

Reagan S. Wood resigned as Chief Operating Officer, Secretary on February 28, 2006. Jennifer Gallegos filled the position of Corporate Secretary, on March 23, 2006. John Javorsky, VP - Information Systems was terminated on July 11, 2006. On June 12, 2006, the Association hired Ted Peck, to fill a newly created office of Chief Information Officer (CIO).

Biographical affidavits for officers and directors were filed with the Department in accordance with U.C.A. § 31A-5-410(1)(a)(ii).

Conflict of Interest Procedure

The Association had an established procedure for disclosing to its board of directors any material affiliation on the part of its officers, directors, or responsible employees, which would likely conflict with the individual's official duties. Each person was required to file an annual statement disclaiming or disclosing any material conflict of interest. The prior examination mentioned possible conflicts. We noted that although there were some disclosures, no exceptions to the established procedure were noted by the examination.

Corporate Records

Minutes of the meetings of the members, directors, and committees were reviewed. The minutes indicated the Association operates within the scope of its authority and the directors were properly informed of and participated in Association affairs. Generally, at each annual board meeting, a detailed report of investment transactions since the previous meeting is presented and approved. In general, the minutes of meetings of members, directors, and committees adequately approved and supported the Association's transactions and events. The Department examination report as of December 31, 2001, was distributed to the board as required by U.C.A. § 31A-2-204(8).

Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance

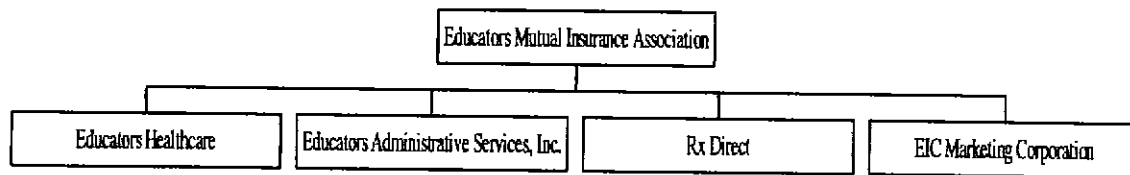
The Association was not involved in any acquisitions, mergers, disposals, dissolutions, and purchases or sales through reinsurance during the examination period.

Surplus Debentures

The Association had no outstanding surplus debentures during the examination period.

AFFILIATED COMPANIES

The Association is wholly owned and controlled by its membership. An organizational chart illustrating the insurance holding company system at December 31, 2005, is as follows:



Educators Administrative Services, Inc. (EASI), formerly Educators Insurance Company, is a Utah for-profit corporation, licensed as a third party administrator of life, accident and health insurance. Educators Health Care (EHC) is a Utah domiciled non-profit health maintenance organization. EIC Marketing Corporation (EICM) is a for-profit brokerage firm organized to market insurance and employee benefit products. RxDirect, Inc. (Rx) is a for-profit prescription benefit management company.

Transactions with Affiliates

The following identifies the Association's management and administrative agreements with affiliates, which define and control various aspects of the Association's transactions and operations as of December 31, 2005.

The Association has management agreements with its various subsidiaries, including EASI, RxDirect and EICM. Under these management agreements, the Association provides administrative and management services to these wholly owned subsidiaries in order that they may perform the services they provide. In return for management services provided by the Association, the subsidiaries pay certain percentages of their annual incomes to the Association for its administrative and management services.

Effective December 17, 1997, the Association entered into an administrative services agreement with EHC, a wholly-owned health maintenance organization. The Association provides marketing and administrative services to EHC. In consideration for the services and the use of the Association's panel providers, EHC pays the Association a sum equal to three-quarters of one-tenth of one percent (.075%) of all medical premiums received, and 9.2% of all dental premiums received by EHC. The fees paid by EHC to EMIA totaled \$262,132 during 2005. The amendment to this agreement, increasing the dental premiums from .075% to 9.2%, was filed with the Department on a Form D during 2004, subsequent to the previous examination recommendation.

The Association assumes 100% of EHC's group medical business pursuant to a reinsurance agreement, effective January 1, 1999. According to Section 1.2 of the agreement, this is a one-year contract for the calendar year 1999. Also, Section 1.1 specifies that premiums will be paid to the reinsurer in arrears. According to discussions with management, and a review of premiums, it was determined that EHC policyholder premiums are deposited directly by the Association (reinsurer) into the Association's bank accounts, with journal entries made to reflect that the premium is EHC's and ceded to the Association. Therefore, in practice, premiums are not paid by EHC in arrears, contrary to the terms of the reinsurance agreement.

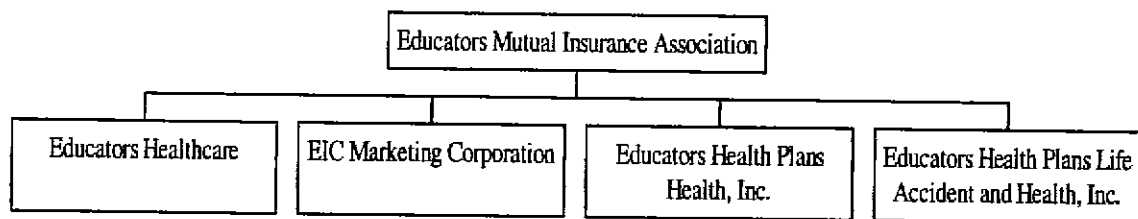
The examiners recommended that the Association amend its reinsurance agreement with EHC for the above-mentioned issues, and review its reinsurance arrangements on a periodic basis to ensure compliance with the clauses of the agreements, and compliance with NAIC and State requirements.

There were certain activities subsequent to the examination date, which are briefly discussed below:

On August 23, 2006, the Association amended the reinsurance agreement with EHC, changing both clauses, and a Form D was filed with the Department.

Pursuant to approval by the Association's board of directors, and Departmental approval, the Association formed two new companies for the purpose of marketing health insurance to commercial groups. A certificate of authority was issued to Educators Health Plans Life, Accident, and Health, Inc. (EHPLA&H) on January 23, 2006, to transact accident and health, life, annuity and variable contract insurance to commercial groups. On January 24, 2006, a certificate of authority was issued to Educators Health Plans Health, Inc. (EHPH) to transact business as a Health Maintenance Organization (HMO).

An organizational chart illustrating the insurance holding company system subsequent to December 31, 2005, as a result of the dissolutions and formations of the new subsidiaries, is as follows:



Subsequent to the examination date, the Association submitted two Form D filings for the Commissioner's approval. On May 15, 2006, the Department approved two new Management Agreements with EHPH and EHPLA&H. The Association provides management services for the newly formed subsidiaries in the same manner as described under the Management Agreements section.

FIDELITY BOND AND OTHER INSURANCE

The minimum fidelity insurance coverage suggested by the National Association of Insurance Commissioners (NAIC) for the Association and its insurance subsidiary is \$500,000. As of the examination date, the Association held fidelity bond coverage with an aggregate liability of \$800,000 and a single loss deductible of \$25,000. The Association was also had general liability policies, and Errors & Omissions and Directors' & Officers' liability policies.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Association provides medical, dental, prescription card, long-term disability, and vision benefits to eligible employees. The Association provides a contribution to the State retirement system in the amount of 14.88% of salary. This amount includes a 1.5% contribution to the State of Utah Retirement System 401 (k) plan. In addition, employees have the option of making voluntary contributions to the Association's 401(k) plan on a tax-deferred basis up to IRS limits. After one year of employment the Association makes a contribution equal to 2% of salary for eligible employees, with graduated vesting periods up to six years. The Association also

contributes an additional 1.5% of compensation for employees who are participating in the noncontributory pension plan.

The Association also provides certain health care insurance benefits (postretirement benefits) for retired employees. The accrual for post-retirement benefits, calculated by an outside actuarial firm, is included in the general expenses due or accrued account in the amount of \$1,545,401. In 2005, the Association changed its post-retirement benefit plan, reducing the number of years that it will pay for retiree premiums. The Association will pay premiums for a maximum of five years when an employee retires at or after age fifty-five with twenty years of service. With twenty, twenty five, and thirty years of service, the Association will pay 50%, 75%, and 100% of the premiums, respectively.

STATUTORY DEPOSITS

The Association's statutory deposit requirement was \$400,000, pursuant to U.C.A. § 31A-4-105. The examination confirmed that the Association maintained a statutory deposit consisting of the following for the benefit of all policyholders, claimants and creditors of the Association, which was adequate to cover the required deposit.

<u>State</u>	<u>Description of Deposit</u>	<u>Par Value</u>	<u>Book Value</u>	<u>Fair Value</u>
Utah	State Deposits - US Treas Notes	\$ 1,100,000	\$ 1,111,063	\$ 1,118,460

INSURANCE PRODUCTS AND RELATED PRACTICES

Policy Forms and Underwriting

The Association provided a list of policy forms filed as of December 31, 2005. A sample review of the policy forms found that they agreed with the Department filings.

Territory and Plan of Operation

As of the examination date, the Association was authorized to conduct life, annuity and accident and health business in the state of Utah. No life or annuity policies were issued during the examination period. The Association issued comprehensive medical, dental, vision and waiver of premium policies as of December 31, 2005. In addition, the Association assumed 100 percent of health policies, other than dental, from its subsidiary, EHC.

The Association's accident and health plan of operation is primarily a self-funded Administrative Services Only (ASO) and Administrative Services Contract (ASC) plans with specific and aggregate stop loss insurance coverage available.

Although a few groups retained fully insured accident and health plans, most of the Association's business is with ASO or ASC plans.

The Association marketed its products through its affiliated brokerage firm, EICM, on a personal contract basis. In addition, the Association provided seminars, training sessions, and faculty meetings with employer groups. The Association also had an advisory panel consisting of some brokers throughout the state that met to discuss products, strategies and issues.

Advertising and Sales Material

The Association does not have traditional advertising. It markets directly to the groups or through brokers, and works with a public relations firm to help improve its image in the community.

Treatment of Policyholders

The Utah complaint register indicated that ten complaints were received by the Department during 2002 through 2005, and they have all been closed. Formal procedures to handle written complaints were determined to be in place within the Association.

The Association received a subpoena dated November 8, 2002, from the U.S. Department of Health and Human Services (HHS), Office of the Inspector General, seeking documents related to the Association's administration of the Medicare Secondary Payer program. The U.S. Government informed the Association that it is also a named defendant in a related qui tam action in the U.S. District Court for the District of Utah. The Association has cooperated with the government investigation while vigorously defending itself against the allegations against it. Nevertheless, the Association has negotiated an out-of-court settlement with the government investigation and the private qui tam lawsuit. The Association paid the settlement of \$2.86 million on July 13, 2004. The Association also paid \$19,203 to the plaintiff's attorneys on July 29, 2004.

During the next three years following the settlement, the Association is to provide to HHS documentation of strict monitoring of activities. We were provided with evidence from the internal auditor that the Association has been working to comply with the HHS requirements.

REINSURANCE

Assumed

As mentioned in the Transactions with Affiliates section, the Association assumes one hundred percent (100%) of EHC's, group medical business, premiums and losses, through a reinsurance agreement effective January 1, 1999. The business assumed includes the Care, CarePlus, HealthChoice, HealthChoice II, Network Select & Select Care products (referred to as "The Plans"). The subsidiary retains no premium or losses on this business.

Ceded

The Association cedes business under essentially two different reinsurance programs.

The medical business is ceded through excess or stop loss reinsurance treaties. At December 31, 2005, the Allianz Medical Excess reinsurance agreement with Allianz Life Insurance Company of North America, which is effective September 1, 2005 through August 31, 2006, covers the medical business of EMIA and each of its subsidiaries, EHC, EHPH and EHPLA&H. This treaty replaces the previous treaty with American Re-insurance Company which ended August 2005. The Allianz treaty provides for three layers of excess coverage. The Company retains the first \$300,000 of loss per member per contract year. The ultimate net loss provided by the three layers is from the first \$300,000 retention up to the level of \$2,500,000. There is a special provision in this treaty for members that utilize the LifeTrac Network Transplant, the excess coverage picks up after the first \$200,000 retention to \$2,500,000.

The reinsurance agreement with Allianz did not contain any clause related to Allianz's timeliness of payment or settlement of claims. The examination recommended that the Association include a clause in its reinsurance agreements specifying the obligations of the reinsurer for payment of claims. Subsequent to the examination date on August 21, 2006, Endorsement No. 2 was added to the Alliance reinsurance agreement. Article 6 Item 6.3 "**Payment of Claims**" was added as follows:

6.3 **Payment of Claims.** Submitted claims will be adjudicated, within 30 calendar days of Allianz Life's receipt of the information in Article 6.2.

The life business is primarily reinsured to The Prudential Insurance Company of America (Prudential) through a yearly renewable term reinsurance agreement for face amounts of group term life, individual life, and accidental death and dismemberment in excess of the Company's retention limit of \$50,000 for any one life. As of January 1, 2004, the life business reinsured by Combined Insurance Company was sold to Prudential.

ACCOUNTS AND RECORDS

The Association utilizes a centralized computer record processing system, supplemented by ancillary records maintained either manually or on personal computers. A trial balance, as of December 31, 2005, was prepared from the Association's general ledger. Account balances were traced to annual statement reports, exhibits, and schedules without material exception. Individual account balances were examined as deemed necessary.

An independent certified public accounting firm audited the Association's records during the period covered by this examination. Audit reports generated by the auditors for the years 2002 through 2005 were made available for the examiner's use.

We noted certain sections of the Association's financial statements that lacked proper reporting or disclosure, as required by the NAIC Annual Statement Instructions. These sections are discussed below.

1. General Interrogatories

The Association did not disclose Schumann Capital Management as its investment advisor in Part 1, No. 24.05 of the General Interrogatories for the period under examination.

We recommend the Association disclose its investment advisor in Part 1 of the General Interrogatories.

2. Schedule E - Part 1 - Cash

On the Annual Statement Schedule E - Part 1 - "Cash", the Association incorrectly listed \$3,260,074 in certificates of deposit as held in suspended depositories. The respective institutions have not been suspended by any regulatory agency.

It is recommended that the Association reclassify their certificates of deposit from the suspended depositories to open depositories category in Schedule E - Part 1.

3. Schedule "S" Disclosure

The Association's Schedule S Part 1, Section 2 refers to the old 1997 reinsurance agreement between EMIA and EHC. This agreement was superseded by the January 1, 1999 agreement.

Schedule S should be updated to reflect the proper reinsurance agreement in force.

4. Real Estate - Sales Contracts Without Title to Transfer

The Association has two agreements, called 'contracts for sale', relating to the \$119,274 real estate balance reported on page 2 – Assets. One contract is with Jordan Educators Association (JEA) and one is with Utah School Employees Association (USEA). There was a third contract with Granite Education Association (GEA) that was fully paid years ago, with no title changing hands. In these sales contracts, EMIA purports that it holds title to a building that it constructed on land leased from UEA under a 90-year property lease. According to the property lease, EMIA was to construct additions to an existing building, in lieu of making monthly lease payments. The lease provides that EMIA is 'deemed' to have the rights of ownership during the lease term, for purposes of insurance, taxes, maintenance and upkeep, etc. Consequently, according to the lease, all property and improvements will revert back to UEA at the end of the lease. This stipulation requires that the lease be reported as an operating lease.

In the 'contracts for sale,' EMIA purports that it has title to transfer to the three entities at full payment of the amount loaned pursuant to the sales contracts. However, EMIA was unable to provide evidence that it holds the titles to be transferred. The county property assessor's office reflects only UEA's ownership of property and building at that location. The Association management maintains that these sales contracts are really more like sub-leases, however the wording says nothing about sub-leases.

During the examination the Department recommended the Association address the wording and the intent of the 'contracts for sale', and make corrections accordingly, whether it be to terminate the sales contracts and enter into sub-leases, or amend the clause discussing transfer of title. It is apparent that there is no title to transfer, and the Association's intent appears to be that of a sub-lease arrangement. Lacking title to transfer, we consider these sales contracts to simply be unsecured loans.

Subsequent to the examination fieldwork date, UEA(Grantor) issued a Quit Claim Deed to EMIA on October 9, 2006 for the "real property beginning at the NW corner of the North wing of the existing UEA Building...subject to a reversionary interest in the Grantor at noon, June 30, 2066 when all of the Grantee's interest shall revert to Grantor." It also entered into a new lease agreement on October 6, 2006, which states "In 1971, UEA leased land to EMIA on which the Subject Building is located. Subsequently, EMIA constructed the Subject Building on the property leased to it by UEA...It appears to have been the intention of the parties that EMIA would own the Subject Building, and that the Subject Building would become the property of UEA at the end of the lease term, subject to any extension requested by EMIA. The lease was most recently amended July 29, 1976 and expires June 30, 2066 when UEA becomes the owner of the Subject Building unless the lease is

extended. The lease authorized EMIA to sublease portions of its Subject Building, which it has, subject to the terms of the UEA/EMIA leases...This Agreement supersedes and replaces all previous agreements made by the parties related to the lease and sale of the premises and Subject Building."

5. Current Federal and Foreign Income Tax Payable

The Association incorrectly reported a \$9,000 franchise tax liability as a federal income tax liability rather than as taxes, licenses and fees. No reclassification is recommended as this amount falls below the materiality level for this examination.

It is recommended that the Association reclassify its franchise tax liability to the taxes, licenses and fees account on future financial statements.

6. Asset Valuation Reserve

The Association's Asset Valuation Reserve (AVR) calculations are not in compliance with the NAIC Annual Statement Instructions regarding accounting for a \$5,610 transfer of other than mortgage loans and a transfer of \$10,928 from the real estate and other invested assets. The net effect of this difference is an increase to AVR of \$16,538. We do not recommend an adjustment, as this amount falls below the materiality level for this examination.

It is recommended that the Association follow the NAIC Annual Statement Instructions for the AVR calculation on future financial statements.

7. 2006 Notes to Financial Statements

Note 1.c.5. in the June 30, 2006 quarterly financial statements, reads "Effective January 31, 2006, Rx Direct, Inc. and Educators Administrative Services Inc. (EASI) were dissolved. All of the assets and liabilities of these two entities were transferred to the Association since it was the sole shareholder. All of the groups previously serviced by Rx Direct and Educators Administrative Services were transferred to the Association for servicing. In turn, the Association contributed all of the former assets of EASI to two new insurance companies; Educators Health Plans Health, Inc. and Educators Health Plans Life, Accident and Health, Inc."

According to the minutes of a meeting held on January 26, 2006, the board of directors unanimously passed a resolution for the dissolution of Rx Direct and EASI. The examination verified with the Utah Department of Commerce that Rx Direct was voluntarily dissolved in May 2006; but EASI is still an active entity. Confirmations were sent to the custodians to verify the assets were transferred to, and held in the names of EHPH and EHPLA&H in accordance with U.C.A. § 31A-4-108. The custodians confirmed the assets were still held under the federal identification number of EASI as of August 2006. Consequently, the invested assets reported by both EHPH and EHPLA&H were not held in compliance with U.C.A. §

31A-4-108. The Association took corrective action during the examination, and the assets were transferred in September 2006, subsequent to and as a result of the examination, into the names and the custodial accounts of EHPH and EHPLA&H.

FINANCIAL STATEMENTS

The following financial statements were prepared from the Association's accounting records and the valuations and determination made during the examination:

BALANCE SHEET as of December 31, 2005

STATEMENT OF REVENUE AND EXPENSES for the Year Ended
December 31, 2005

RECONCILIATION OF CAPITAL AND SURPLUS – 2001 through 2005

The Association NOTES TO FINANCIAL STATEMENTS are an integral part of the financial statements.

EDUCATORS MUTUAL INSURANCE ASSOCIATION

BALANCE SHEET as of December 31, 2005

	Net Admitted Assets
<u>ASSETS</u>	
Bonds	\$ 29,759,947
Preferred stocks	2,199,766
Common stocks	4,481,014
Real estate - Properties occupied by the company	1,378,890
Cash and short-term investments	9,202,038
Investment income due and accrued	513,633
Uncollected premiums and agents' balances	1,079,329
Deferred premiums	5,000
Reinsurance - Amounts recoverable from reinsurers	279,865
Amounts receivable relating to uninsured plans	266,314
Electronic data processing equipment & software	327,091
Receivable from parent, subsidiaries & affiliates	555,138
Health care and other amounts receivable	451,775
Total assets	<u>\$ 50,499,799</u>
<u>LIABILITIES</u>	
Aggregate reserve for life contracts	\$ 889,874
Aggregate reserve for accident and health contracts	7,954,862
Contract claims - Life	8,801
Contract claims - Accident and health	6,354,387
Premiums and annuity considerations	283,402
Interest Maintenance Reserve	1,228,112
General expenses due and accrued	2,510,872
Taxes, licenses and fees due or accrued	26,538
Current federal and foreign income taxes	82,000
Amounts withheld or retained as agent or trustee	912,363
Asset Valuation Reserve	826,629
Payable to parent, subsidiaries and affiliates	39,051
Liability for amounts held under uninsured plans	3,466,314
Payable for securities	754,575
Aggregate write-ins for liabilities	1,165,783
Total liabilities	<u>\$ 26,503,563</u>
<u>CAPITAL AND SURPLUS</u>	
Unassigned funds (surplus)	23,996,236
Total capital and surplus	<u>23,996,236</u>
Total liabilities, capital and surplus	<u>\$ 50,499,799</u>

EDUCATORS MUTUAL INSURANCE ASSOCIATION

SUMMARY OF OPERATIONS for the Year Ended December 31, 2005

	<u>Total</u>
Premiums and annuity considerations	\$ 42,972,779
Net investment income	2,318,980
Amortization of Interest Maintenance Reserve	131,298
Aggregate write-ins for miscellaneous income	2,582,592
Totals	<u>48,005,649</u>
Death benefits	11,204
Disability benefits	41,493,820
Increase in aggregate reserves	<u>(3,918,081)</u>
Totals	<u>37,586,943</u>
Commissions on premiums	199,326
General insurance expenses	4,892,907
Insurance taxes, licenses and fees	467,659
Totals	<u>43,146,835</u>
Net gain from operations before taxes	<u>4,858,814</u>
Federal and foreign income taxes incurred	<u>82,000</u>
Net gain from operations after dividends and taxes	4,776,814
Net realized capital gains (losses)	16,028
Net income	<u><u>\$ 4,792,842</u></u>

EDUCATORS MUTUAL INSURANCE ASSOCIATION
RECONCILIATION OF CAPITAL AND SURPLUS ACCOUNT
2001 through 2005

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>Per Exam 2005</u>
Capital and surplus, December 31, previous year	\$ 15,142,557	\$ 20,552,102	\$ 20,816,900	\$ 18,841,023
Net income	5,498,680	(505,121)	(2,685,748)	4,792,842
Change in net unrealized capital gains (losses)	(83,954)	506,369	500,173	551,733
Change in nonadmitted assets	97,502	192,583	123,720	(89,366)
Change in asset valuation reserve	(102,684)	70,968	85,977	(99,996)
Net change in capital and surplus for the year	<u>5,409,545</u>	<u>264,799</u>	<u>(1,975,878)</u>	<u>5,155,213</u>
Capital and surplus end of reporting	<u>\$ 20,552,102</u>	<u>\$ 20,816,900</u>	<u>\$ 18,841,023</u>	<u>\$ 23,996,236</u>

* Per the regulatory financial statements filed with the Utah Insurance Department.

NOTES TO FINANCIAL STATEMENTS

The Association's capital and surplus was determined to be \$23,996,236, as reported in the Association's annual statement as of December 31, 2005. The Association's minimum capital requirement was \$400,000 as defined in U.C.A. §31A-5-211(2)(a). As defined by U.C.A. § 31A-17 Part 6, the Association had total adjusted capital of \$24,882,865, which exceeded the Association's action level risk-based capital (RBC) requirement of \$8,490,136 by \$16,332,729.

SUMMARY OF EXAMINATION FINDINGS

Items of significance commented on in this report are summarized below:

1. Premiums were not paid by EHC in arrears, contrary to Section 1.1 of the reinsurance agreement. The Association amended its reinsurance agreement with its affiliate during the examination to properly reflect its reinsurance arrangement, whereby premiums are collected by the Association, then journal entries are made to reflect that the premium is EHC's and ceded to the Association. The Department recommends the Association review its reinsurance and related party agreements on a regular basis for compliance issues. (Transactions with Affiliates)
2. According to the minutes of the meeting of the Board of Directors, the Association reported that on January 26, 2006, it dissolved two of its existing subsidiaries, Rx Direct and EASI, and formed two new subsidiaries EHPH and EHPLA&H. All of the invested assets of EASI were to be divided and distributed to the two new entities as contributed capital. Confirmations of the cash and investments obtained by the examination in August 2006 indicated the invested assets remained in the name of EASI. Consequently, the invested assets reported by both EHPH and EHPLA&H were not held in compliance with U.C.A. § 31A-4-108. The Association took corrective action during the examination, and the assets were transferred in September 2006, subsequent to the examination, into the names and the custodial accounts of EHPH and EHPLA&H. (ACCOUNTS AND RECORDS)
3. The Allianz Medical Excess Reinsurance Agreement did not contain a clause specifying Allianz's timeliness of payment or settlement of claims.

Subsequent to the examination date, on August 21, 2006, Endorsement No. 2 was added to the Alliance reinsurance agreement. Article 6 Item 6.3 "**Payment of Claims**" was added as follows:

6.3 **Payment of Claims.** Submitted claims will be adjudicated, within 30 calendar days of Allianz Life's receipt of the information in Article 6.2.
(REINSURANCE Ceded)

4. During the period covered by this examination, the U.S. Department of Health and Human Services (HHS), and the Office of the Inspector General held an

investigation of the Association on its secondary payer practices. The Association was a named defendant in a qui tam action in the U.S. District Court for the District of Utah, and negotiated an out-of-court settlement with the government investigation and the private qui tam lawsuit. The Association paid a settlement of \$2.86 million on July 13, 2004, pursuant to this settlement, and has agreed to a three year monitoring by the HHS. The Department encourages the Association to continue with its ongoing monitoring efforts. (Treatment of Policyholders)

5. There were various errors in the annual statement. Errors in reporting were an issue in the prior two reports of examination. It is recommended that the Association take necessary precautions and steps to thoroughly review its annual statement presentation prior to issuing and filing its statements. (ACCOUNTS AND RECORDS)

CONCLUSION

Participating on this examination, were examiners Ed Fossa, CFE, and Don Catmull, CFE, Brandon Thomas, IS Specialist, and James MacDougall, FSA, MAAA, of Marsh Actuarial Consulting, Inc. Colette Reddoor, CFE, Assistant Chief Examiner and Neeraj Gupta, CFE supervised the examination. They join the undersigned in acknowledging the assistance and cooperation extended during the course of the examination by officers, employees, and representatives of the Association.

Respectfully Submitted,



Carolyn Maynard, CFE

Examiner-In-Charge, representing the
Utah Insurance Department